

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702, 704, 712, 723, 742

Prompt Corrective Action; Corporate Credit Unions; Credit Union Service Organizations; Member Business Loans; Regulatory Flexibility Program

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Rule.

SUMMARY: NCUA is amending its member business loan (MBL) regulations to provide greater flexibility to credit unions to meet the business loan needs of their members within statutory limits and appropriate safety and soundness parameters. Major changes include: (1) reducing construction and development loan equity requirements; (2) allowing RegFlex credit unions to make their own decisions whether to require personal guarantees by principals; (3) allowing well-capitalized credit unions to make unsecured MBLs within certain limits; (4) providing that purchases of nonmember loans and nonmember participation interests do not count against a credit union's aggregate MBL limit, subject to an application and approval process; (5) allowing 100% financing on certain business purpose loans secured by vehicles; (6)

providing that loans to credit unions and credit union service organizations (CUSOs) are not MBLs for purposes of the rule; and (7) simplifying MBL documentation requirements. Other provisions in the MBL regulation are simplified and unnecessary provisions are removed. In addition, NCUA is amending the prompt corrective action (PCA) rule regarding the risk weighting of MBLs and the CUSO rule to permit CUSOs to originate business loans.

DATES: This rule is effective October 31, 2003.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

FOR FURTHER INFORMATION CONTACT: David M. Marquis, Director, Office of Examination and Insurance, at the above address or telephone (703) 518-6360; Robert M. Fenner, General Counsel, or Chrisanthy J. Loizos, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Background

On March 27, 2003, the NCUA Board issued a Notice of Proposed Rulemaking to amend the MBL rule and other rules as they relate to business lending. 68 FR 16450,

Apr. 4, 2003. In the proposed rule, the Board provided some parity for federal credit unions (FCUs) with federally insured, state-chartered credit unions (FISCUs) that are exempt from NCUA's MBL rule because the Board had determined that their chartering states had developed MBL rules that minimize risk and accomplish the overall objectives of NCUA's rule. The parity provisions in the proposed rule addressed construction and development loan equity requirements, personal guarantees by principals, and unsecured MBLs. The proposed rule also revised certain provisions that have created unnecessary regulatory burden and clarified certain provisions that have caused confusion. These proposed amendments related to: the dollar amount that triggers compliance with the rule, the loans to one borrower limit, the aggregate MBL limit, loan-to-value (LTV) requirements, MBL documentation requirements, and the loan loss reserve requirements. The Board also proposed that credit unions that purchase participation interests in MBLs made to credit union members need not count the purchase against the credit union's own limit. Finally, the proposed rule expanded the current standard risk-based net worth (RBNW) component for MBLs in the PCA rule and authorized CUSOs to originate business loans.

In the preamble to the proposed rule, the Board noted that the proposed amendments to the MBL rule would allow credit unions greater opportunities to meet the small business loan needs of their members without creating undue risk to the National Credit Union Share Insurance Fund. The Board cautions, however, that MBLs are not suitable for all credit unions. Credit union management must demonstrate a higher standard in

planning, policies, procedures, controls, monitoring, credit risk, and diversification to safely establish a long-term strategy in member business lending.

B. Comments

General

NCUA received three hundred and ninety timely comment letters on the proposed rule.

NCUA staff, however, credited multiple comment letters from the same commenting organization as one comment letter for a total of three hundred and fifty-one letters.

NCUA received comments from two hundred and seventy-six credit unions, twenty-five credit union trade organizations, one CUSO, two corporate credit unions, one corporate CUSO, one CUSO trade organization, two law firms, two consultants, one journalist, fourteen bank trade organizations, twenty banks, one federal agency, one association of state supervisors, three credit union members, and one letter from two members of the U.S. House of Representatives.

Two hundred and ninety-two commenters generally supported the Board's proposal.

Many of these commenters stated the changes would improve the ability of credit unions to meet the small business loan needs of their members. Others noted that credit union members need an affordable source of funds to finance and grow their small businesses. They said the proposed rule allows credit unions the ability to serve all of their members' financial needs. Some commenters stated small business owners need every available resource to continue to operate in a competitive economy and that low cost MBLs would allow many businesses to continue their efforts at economic

success. They also noted small businesses are the backbone of our nation's economy and are often owned and operated by credit union members. One commenter stated that, as an ex-banker, he felt strongly that many small businesses face unmet credit needs today due to minimum loan amount requirements by large banks and bank holding companies.

Commenters also found that the proposed rules reduce some of the expense burden associated with the current regulations and provide a more manageable solution to business lending. These commenters stated credit unions, their members, and small businesses will benefit from these changes. Several commenters said the current rules are overly restrictive vis-à-vis the competitive marketplace and that the restrictions have forced members to take their small business loan needs to other financial institutions, although they would prefer to do business with the credit union. One commenter stated that the need for small business capital is a niche that credit unions should be allowed and encouraged to fill. This commenter also noted that as not-for-profit cooperatives, credit unions exist to fulfill the legitimate demands of their members, including their demand for MBLs.

NCUA also received a letter from two members of Congress on the House Financial Services Committee stating that, as authors of the Credit Union Membership Access Act (CUMAA), they were pleased to see that the NCUA Board used the latitude that was appropriately conferred upon the agency by law in preparing these beneficial changes. 12 U.S.C. 1757a, Pub. L. 105-219, 112 Stat. 913 (1998). The congressional

representatives urged the Board to fully utilize the discretionary authority conferred on it by Congress to facilitate credit union lending in this important and oftentimes underserved area, and to refrain from imposing any limitations upon credit union member business lending not explicitly called for by Congress when it enacted CUMAA.

Thirty-three bank-affiliated commenters strongly opposed the proposed changes to NCUA's MBL rule, stating the proposed amendments are contrary to congressional intent to limit business lending by credit unions. These commenters stated the proposed amendments significantly erode congressional intent when it adopted CUMAA and that Congress made it perfectly clear that credit unions should be focused on consumer lending, not commercial lending. These commenters also stated the proposed rule will divert credit union resources to financing commercial enterprises, while relaxing safety and soundness regulations associated with MBLs.

Three bank commenters stated it is a tremendous mistake to encourage the growth of tax-exempt businesses, particularly when that growth comes at the expense of tax-paying businesses. One commenter stated its organization does not oppose the liberalization of the current MBL rule but does oppose continued tax exempt status for credit unions engaged in commercial lending. Three bank commenters stated the rule creates additional unfair competition with America's small community banks because small business loans are an essential part of their loan portfolio and are what they call their "bread and butter" loans. They noted that, without business loans, their existence

is jeopardized. Two bank commenters stated credit unions should not be in commercial lending at all.

The U.S. Department of Treasury submitted a comment letter supporting the commitment of credit unions to their members through MBL programs, but objecting to certain provisions of the proposed rule. The Treasury Department objected to the proposed treatment of participation interests, suggesting that the proposal would undermine the intent of Congress with respect to limitations on credit union business lending. The Treasury Department also commented that the proposed removal of the personal guarantee requirement and the proposed authority to make unsecured MBLs may raise safety and soundness concerns by eliminating key provisions that have limited credit risk on MBLs.

Other Suggestions

Commenters offered numerous suggestions to amend the MBL rule that are outside the scope of the issues on which the Board sought comment. The most significant comments dealt with altering the MBL rule so that it could be better aligned with lending programs offered by the Small Business Administration (SBA); changing the LTV definition; and clarifying other provisions in the current MBL rule. NCUA is reviewing these comments and will assess whether to amend the MBL rule further at a future date, in compliance with its responsibilities under the Administrative Procedure Act, 5

U.S.C. 553, to offer the public the opportunity to review and comment on any proposed amendments.

C. Section-by-Section Analysis

Loans to Credit Unions and CUSOs, Sections 723.1(c), 704.11(b)

Paragraph (c) of §723.1 clarifies that loans made by federal, natural person credit unions to other natural person credit unions and CUSOs are not MBLs because the Federal Credit Union Act grants FCUs express authority to lend to credit unions and CUSOs, in addition to their authority to make MBLs. 12 U.S.C. 1757(5)(C), (D). It also permits FISCUs to exclude loans to credit unions and CUSOs in calculating their aggregate MBL limit if the state supervisory authority determines that FISCUs have authority to lend to credit unions and CUSOs separately from the general authority to grant loans to members. In the absence of authority similar to that in the Federal Credit Union Act, a FISCU's loans to credit unions and CUSOs are subject to the MBL rule.

The final rule includes a corresponding amendment to NCUA's corporate credit union rule to conform to the MBL rule regarding loans to corporate CUSOs by removing the requirement that a corporate credit union's loans to corporate CUSOs be included in the MBL rule's aggregate loan limit, 12 CFR 704.11(b)(4).

Forty-six commenters specifically supported the clarification that loans to credit unions and CUSOs are not MBLs. Two of these commenters supported this exclusion from the MBL limit because they stated a credit union should be allowed to use the entire percentage of its MBL cap to make MBLs, as intended. Many of the commenters stated the clarification eliminates confusion when calculating MBL caps. They noted credit unions are already restricted in the aggregate amount they can lend to a CUSO by law or regulation and are permitted by law to make loans to other credit unions. One commenter noted many smaller credit unions receive deposits from larger credit unions and many credit unions make loans to each other. This commenter stated these loans represent the cooperative spirit of credit unions and are not MBLs. Three commenters stated credit unions may lend to other credit unions or CUSOs for investment purposes; excluding such loans from the MBL rule preserves those investment options while affording a credit union more opportunity to grow a business loan portfolio aimed at the commercial or agricultural needs of the membership.

Two commenters stated the language in the proposed rule wrongly provided for FISCUs to exclude loans to credit unions and CUSOs only if there is independent authority for such loans under state law. They noted the state's authority may be statutorily specific, statutorily implied, by regulation, or by agency interpretation and that the provision should be revised accordingly. The Board agrees and revised the language in the final rule to address this concern by removing the requirement that there be independent authority in state law.

Ten commenters agreed that corporate credit union loans to corporate CUSOs should not be subject to the aggregate MBL limits. Some of these commenters supported the change because these loans serve as investments for corporate credit unions and corporate credit unions are the liquidity providers for the credit union movement. The Board notes that, while they need not include loans to corporate CUSOs in calculating their aggregate MBL loan limit, corporate credit unions remain subject to §704.11(c), which specifically requires them to comply with certain due diligence requirements in the MBL rule for loans to corporate CUSOs.

Loan Participations, Section 723.1(d), (e)

Paragraph (d) of §723.1 requires a credit union to subject purchased business loans or participation interests in business loans that another lender made to members of the purchasing credit union to parts 723 and 702 as if the credit union had originated the loans to its members. Paragraph (e) of §723.1 permits a credit union to exclude purchased business loans or participation interests in business loans that another lender made to nonmembers of the purchasing credit union from the MBL aggregate limit under the conditions set forth in §723.16.

Section 723.1(d) of the proposed rule provided that any interest obtained in a participation loan would be excluded in determining the purchasing credit union's aggregate MBL limit but that the participation interest would otherwise be treated the same as a business loan made by the credit union. The effect of this proposal was to subject purchased participation interests in business loans to all of the safety and

soundness requirements of NCUA's rules, without requiring the purchasing credit union to count participation interests in loans originated by other lenders against its aggregate MBL limit. While the proposal did not specifically address purchases of whole loans, authorized for RegFlex credit unions pursuant to 12 CFR part 742, the same logic would apply to those purchases.

Credit union commenters were largely supportive of the proposal, although some questioned the basis for distinguishing between loans originated by a credit union and those purchased from another lender. Banks and their representatives argued that the proposal was inconsistent with congressional intent to limit business lending by credit unions, and that it presented unfair competition to community bankers. The U.S. Treasury Department commented that the proposed treatment of participation interests would create a "loophole" to escape the aggregate limit on individual credit unions established by Congress. On the other hand, two congressional sponsors of the CUMAA urged NCUA to use its maximum flexibility to enable credit unions to meet their members' business loan needs.

The Board has made two changes from the proposed rule to address the concerns raised by the commenters and ensure that the treatment of loan purchases and participation interests does not result in circumvention of the aggregate limit. First, the final rule provides that, if a credit union holds an interest in a business purpose loan of its member, the interest will be treated the same irrespective of whether it was made by the credit union or purchased from another lender. If a loan is to a credit union's own

member for more than \$50,000, and not otherwise excluded from the definition of an MBL, the credit union must treat it as an MBL for all purposes, including the aggregate limit. This change is accomplished by adding a new subsection (d) to §723.1, “What is a Member Business Loan?” The new subsection clarifies that purchased member loans and member participation interests are MBLs for all purposes under the final rule.¹

Second, with respect to nonmember loans and nonmember participation interests, the final rule provides that they will be treated the same as an MBL for all purposes except the aggregate MBL limit. The total of such nonmember loans, when added to member loans, may exceed the aggregate limit on member loans only if approved by the NCUA Regional Director pursuant to an application and review process. Section 723.1(e) reflects this change and contains a cross reference to new §723.16(b) that establishes the application process. The reasons for this treatment of nonmember loans are addressed in detail in the discussion of §723.16 below.

Construction and Development Lending, Section 723.3

Section 723.3 sets a new borrower equity requirement and establishes exceptions to the limits imposed on construction and development MBLs. This section requires a borrower to have a minimum of a 25%, rather than a 35%, equity interest in any construction or land development project. It also creates specialized standards for financing the construction of single-family residential properties by professional homebuilders by excluding these MBLs from the aggregate construction and

¹ In addition to the provisions of part 723, credit unions may also be subject to the requirements or authorities granted in other applicable regulations governing loan participations, eligible obligations, and loan purchases by RegFlex designated credit unions. 12 CFR §§701.22, 701.23, 742.5.

development MBL aggregate limit and the borrower equity requirement under certain circumstances.

Ninety-four commenters welcomed the reduced borrower equity requirement of 25%. Many of these commenters stated this minimum equity interest requirement should provide sufficient collateral for a credit union and adequate incentive for a borrower to complete a project. Some commenters stated the lowered equity interest requirement will help credit unions assist more small business owners and put credit unions on equal footing with other financial institutions. Twenty-two commenters said the revision will provide flexibility for both the borrower and the credit union without negatively impacting safety and soundness. One commenter noted that lowering the equity requirement reduces the additional burden on credit unions to secure a waiver from the 35% equity interest requirement.

Eight commenters recommended an even lower percentage for the mandatory equity requirement to be competitive with the market. One stated the requirement should be set at 20% and another suggested that the rule permit waivers to 20%. One commenter asked that the rule allow for a lower percentage when a government agency has provided a guarantee or advance commitment on the loan. Another stated that the proposal was a step in the right direction but would prefer if the minimum equity requirement was lowered to 10% if principals give their personal liability and guarantee. A few commenters raised concerns about the equity requirement in relation to the current rule's definition of LTV. They suggested that the agency adopt the FFIEC

Interagency Guidelines for Real Estate Lending that establish supervisory limits on LTV ratios on construction and development MBLs. 12 CFR part 34, subpart D, appendix A.

The final rule retains the equity requirement as proposed. The Board continues to regard the borrower equity interest in construction and development projects and the MBL rule's LTV section, §723.6, as important tools for safe and sound business lending, just as it did when the Board first adopted these requirements in 1991. "Collateral requirements are imposed as a hedge against the potential for borrower default. Additionally, LTV ratios implicitly produce powerful incentives to encourage borrowers to repay, e.g., to protect the borrower's equity interest in the property. These incentives do not exist with high LTV ratios, where the borrower has little, if any, equity at risk. Accordingly it is critical that sufficient equity be available to protect the lender's interest." 56 FR 48421, 48423, Sep. 25, 1991. The Board also continues to view construction and development loans as containing the largest overall risks to business lending. See id. at 48424. It believes, therefore, that the requirement for a borrower to have a 25% equity interest in a construction or land development project is appropriate. A credit union, however, may apply for a waiver of this requirement. 12 CFR 723.10.

The FFIEC Interagency Guidelines for Real Estate may provide more flexibility for other financial institutions because, for example, the Guidelines do not require any equity interest but establish LTV limits for certain transactions. Some of the relevant FFIEC supervisory limits are set as follows: 65% LTV for raw land; 75% LTV for land development; and 80% LTV for commercial construction loans. 12 CFR part 34,

subpart D, appendix A. As noted above, however, comments directed at the rule's LTV definition are not relevant to this current rulemaking because the Board did not seek public comment on any changes to that definition. These comments, as well as the suggestion to review the FFIEC Interagency Guidelines for Real Estate Lending, remain under consideration and may be addressed by future rulemaking.

Finally, commenters asked for clarification about the borrower's equity requirement and whether it is based on the cost amount of the project or the appraised value of the project upon completion. In NCUA legal opinion 01-0422, dated June 7, 2001, the Office of the General Counsel stated that a borrower's equity interest in a project may include down-payment money and the value of land owned by the borrower on which the project is to be built, less any liens. The legal opinion letter also states that, because construction and development projects are typically very speculative in nature, appraisals that attempt to determine the future market value of the completed project tend to be unreliable. Accordingly, NCUA believes it is more prudent to use the market value of the project at the time the loan is made to determine the value of the financed project. This includes the appraised value of land owned by the borrower on which the project is to be built, less any liens, plus the cost to build the project. To adopt the agency's position and clarify this issue for commenters, the final rule states that credit unions must use the current market value of the project in determining its value.

Section 723.3 reduces the regulatory burden for members engaged in the business of constructing single-family residential properties. First, in the case of a loan to finance

the construction of a single-family residence where a contract already exists between the builder, who is a member-borrower, and a prospective homeowner, the final rule provides that such a loan is not subject to the aggregate 15% of net worth limit of §723.3(a) or the 25% equity interest requirement. These loans need only comply with the LTV requirements of §723.7. Second, the final rule grants this same relief from the aggregate net worth limit and the equity interest requirement for one construction or development loan per member-borrower or group of associated member-borrowers for a single-family residence, irrespective of the existence of a contract with a prospective homeowner.

When making construction and development loans that are exempt from the equity requirements in §723.3 but subject to the LTV requirements of §723.7, credit unions must use the market value of the project at the time the loan is made, as discussed above, when determining the appropriate LTV limits.

Eleven commenters supported the exemptions for the financing of single-family residential properties. Several of these commenters stated that the Federal Credit Union Act charges credit unions to extend credit for provident purposes. They found the exclusions for the construction of single family residences enable credit unions to assist their members in achieving home ownership because increased credit union construction financing will enhance the marketplace for readily saleable homes in every community. In short, they stated this regulation opens a door for credit unions to increase the types of service they can offer to their communities.

Two commenters asked for clarification on these provisions because they were unclear as to the number of loans a member homebuilder may have with the credit union under these exclusions. The final rule allows the homebuilder to have as many loans as it has sales contracts with future homeowners, plus one loan for a home for which the homebuilder does not yet have a sales contract, subject to the loans to one borrower limit in §723.8. When the credit union applies the rule's exceptions to its first speculative-type loan made to a homebuilder, that loan remains exempt from the 25% equity requirements and excluded from the 15% net worth limit of §723.3 until the builder pays off the loan. Once it is fully paid, the credit union may exclude a new speculative loan made to the builder from the 15% net worth limitation and subject the loan to the LTV requirements of §723.7. This is contrasted with an outstanding speculative loan to the builder. The credit union cannot exclude an outstanding speculative loan it made during the time the builder was repaying the first exempt loan because any additional speculative loans to the builder during that time must have been made under all of the conditions of §723.3.

Three commenters noted that the proposed §723.3(b) excluded certain construction loans if the prospective homeowner contracted to purchase and reside in the property, but that typically prospective homeowners do not contract to reside in a property. They asked, therefore, that this wording be removed. The Board agrees and amended the final rule accordingly. These commenters also asked the Board to expand the exclusion to one-to-four family dwellings. The final rule maintains the more restrictive provision as

proposed, limiting the exclusions to single-family residences. The Board has determined not to extend the exclusion to multi-family dwellings as these dwellings have an investment component for the purchaser.

Direct Experience Requirement, Section 723.5

The final rule amends this section by requiring that the person meeting the rule's mandatory two years of direct experience requirement have sufficient experience given the complexity and risk exposure of the credit union's MBLs. It also requires that a third party meeting the experience requirement be independent from the transaction, but establishes three exceptions from this standard.

Seventy-four commenters supported the agency's intent for this proposal. Most of these commenters stated that the rule would make it easier to find individuals qualified to act as an MBL officer by allowing credit unions to engage the services of a third party with direct experience in MBLs under certain conditions so as to avoid potential conflict of interest. They also stated that it allows credit unions to make MBLs without creating a costly infrastructure to meet the experience requirement. The Board wants to clarify that credit unions have been able to use third parties to meet the experience requirement since the 1991 final MBL rule. 56 FR 48421, Sep. 25, 1991. This rulemaking bolsters the experience requirement by ensuring that the individual's experience is relevant to the types of MBLs the credit union makes and that the individual does not have interests that conflict with the credit union's interests.

Six commenters asked for clarification regarding the agency's standard for the requisite lending experience. In 1999, the Board stated that the "experience requirement can be met by either general business lending experience or experience with granting loans for a particular purpose or secured by a particular collateral." 64 FR 28721, 28723, May 27, 1999. The final rule has a more specific standard requiring a credit union to obtain the services of someone with experience tailored to the credit union's needs.

Individuals who meet the requirements of this section must have lending experience directly related to the type of MBLs the credit union intends to offer. These individuals must be familiar with the proper underwriting, analysis, and origination of loans of a particular type in order to understand their complexity and risk exposure. For example, an individual with experience solely in taxi cab loans does not have the requisite experience necessary to underwrite a loan to the taxi company for a gas station, because the individual will be unfamiliar with related issues that may impact the loan, such as environmental laws applicable to underground storage tanks. Likewise, an individual who only has experience with financing residential real estate for homebuilders does not have sufficient lending experience for the land development and construction, or purchase, of a commercial strip center.

Thirty-three commenters found the prohibition against a third party having an interest or involvement in the transaction too restrictive. Most of these commenters stated that the proposal limited a credit union's ability to use third-party service providers and should not be adopted in the final rule. They stated that, while improper personal financial gain

cannot be tolerated, a paid third party's interest and involvement is necessary to provide the assistance many credit unions need to make MBLs. One commenter opposed the requirement stating that it would preclude smaller credit unions from having agreements with larger credit unions that have experience underwriting MBLs and then selling participations to that credit union. Two commenters suggested that, in any transaction in which a third party is retained, a credit union should obtain written disclosures of actual or potential relationships and fee arrangements the third party may have in the transaction. Another commenter stated that the proposal was worded too broadly. The Board agrees that the proposal required some revision. The final rule amends the proposed language to more accurately reflect the Board's concerns by establishing a general conflicts of interest standard and exceptions to the standard.

In order for a credit union to engage in business lending in a safe and sound manner, it is crucial for the credit union to maintain strong internal controls and to have independent, experienced personnel involved in making lending decisions that are in the best interests of the credit union. The credit union must perform its own due diligence, both when the credit union makes MBLs and when it purchases MBLs or MBL participation interests, through the services of an individual who meets the requirements in §723.5. The final rule does not prevent a third party who has the direct experience necessary for a credit union to make MBLs from providing services to the credit union such as document preparation, annual reviews, or loan servicing.

The final rule generally prevents a credit union from relying on a seller's due diligence and experience when the credit union is purchasing MBLs or participation interests in MBLs from the seller. Regardless of whether the seller is, for instance, another credit union or CUSO, the purchasing credit union cannot meet the direct experience requirements of §723.5 by depending on the advice of the experienced individual(s) who performed the underwriting for the originating lender unless: (1) staff for the purchasing credit union performed the loan analysis for the originating credit union; or (2) the CUSO exception in §723.5(b)(3) applies. The final rule bars a credit union from using a third party who has an interest in either the sale of the loan or the collateral securing the loan. It does not bar a smaller credit union from subsequently selling participations to a larger credit union that had advised the credit union when it originated the MBL.

Under the CUSO exception in paragraph (b)(3), a credit union may comply with §723.5 when purchasing a participation interest or eligible obligation from a CUSO, if the experienced individual is employed by a CUSO in which the credit union has a "controlling financial interest" as determined under the Generally Accepted Accounting Principles, even though the CUSO is both the originator and underwriter of the loan.

Member Business Loan Policy, Section 723.6

This section is amended to require credit unions to adopt analysis and documentation requirements within their MBL policies that are consistent with appropriate underwriting

and due diligence standards for the types of MBLs the credit union makes, without detailing required documents. Documentation and underwriting criteria for an MBL may vary depending on the type of business requesting the loan and type of loan requested. The final rule also makes a technical amendment to 12 CFR 704.11(c) to reflect the redesignation of paragraphs in §723.6.

One hundred and twelve commenters supported the proposal. The vast majority of these commenters noted it would greatly expedite the MBL process by eliminating unnecessary documentation and reducing staff time spent on MBL documentation. Many commenters stated it is appropriate for a credit union to adopt documentation requirements in its own policy relative to the types of loans being made. They said that simpler transactions should be subject to fewer documentation requirements than more complex ones, as long as reasonable standards of safety and soundness are met. The final rule adopts the revisions to §723.6 as proposed.

Loan-to-Value Ratio, Section 723.7

The final rule makes several amendments to this section. First, the final rule uses plain English to describe the LTV requirements instead of a chart. Second, the final rule retains the personal liability and guarantee requirement but no longer requires RegFlex credit unions to obtain these guarantees from principals. Third, the final rule permits

credit unions to make unsecured MBLs, in addition to credit card line of credit programs offered to nonnatural person members, if: (1) the credit union is “well-capitalized” as defined in 12 CFR 702.102(a)(1); (2) the aggregate of unsecured MBLs to one borrower does not exceed the lesser of \$100,000 or 2.5% of the credit union’s net worth; (3) the aggregate of all of the credit union’s unsecured MBLs does not exceed 10% of the credit union’s net worth; and (4) the credit union addresses unsecured loans in its written MBL policy. The final rule reorganizes the waiver provisions of §723.10 and permits credit unions to apply for waivers from the unsecured MBLs to one borrower limitation and the aggregate unsecured loan limitation under this section. Finally, §723.7 excludes MBLs made for the purchase of consumer-type vehicles from the rule’s LTV requirements if the vehicle is a car, van, pick-up truck, or sports utility vehicle (SUV) that is used for commercial purposes.

A few commenters favored removing the LTV chart for a plain English description of the LTV requirements. One commenter stated, however, that credit unions may misunderstand the rule’s clarification that government guarantees may not be used in place of the collateral requirements of §723.7. While the Board recognizes the distinction between the rule’s collateral requirements and advance commitments or loan guarantees issued by government agencies, the Board believes it is helpful to maintain this clarification in the final rule. As stated in §723.7(a)(2), the MBL rule does not permit guarantees as replacements for collateral requirements. Borrowers must meet the LTV requirements on the total loan amount from the credit union even if a portion of the loan amount is guaranteed by a government agency. This measure provides the credit union

the necessary security in the event the borrower fails to meet the terms of the government guarantee or commitment. The Board notes this provision does not introduce a new requirement but merely clarifies the existing rule. The final rule also contains a correction by replacing “minimum” with “maximum” to describe the LTV ratio limits prescribed in §723.3(a) that are unchanged from the 1999 version of the rule.

Section 723.7(b) requires the personal guarantee of all principals in the case of an MBL to a corporate or other organizational member. The only exception is for certain not-for-profit organizations. The proposed rule would have deleted this requirement and allowed the board of directors of each credit union to determine whether to require personal guarantees through its business loan policies. The proposal noted that states that have received exemptions from the NCUA rule have not required personal guarantees and that there is no indication of increased losses or other safety and soundness problems in those states.

While most commenters supported this proposal, a number of commenters, including some credit unions, objected. The views expressed by these commenters included: (1) that the personal guarantee requirement is one of the key reasons that credit union MBLs have been less risky than those of other lenders; (2) that if the principals are not willing to stand behind an MBL, the credit union should not grant it; (3) that without the guarantee requirement future loss experience will be greater; and (4) increased loss experience will be to the detriment of credit unions generally, not just those comparatively few credit unions that choose to make MBLs. Commenters also noted

that the exemptions granted to individual states are relatively new and suggested additional monitoring of those states is warranted before eliminating the requirement altogether.

In response to the comments, and after further consideration of the safety and soundness implications of the proposal, the Board has determined to remove the personal guarantee requirement only for those credit unions having RegFlex status under 12 CFR part 742. The personal guarantee requirement is removed for both federal and federally insured state-chartered credit unions meeting the standards of Part 742. RegFlex credit unions generally have a net worth ratio of 9% or more and a high supervisory rating. The Board believes there is little additional safety and soundness risk to the credit union system in allowing RegFlex credit unions that have MBL programs to make their own decisions about requiring personal guarantees. This change is reflected by amending §723.7(b), the personal guarantee requirement, to state that it does not apply to RegFlex credit unions, and by amending NCUA's RegFlex rule, at §742.4, to add §723.7(b) to the list of regulatory requirements from which RegFlex are exempt. Credit unions that do not have RegFlex status may apply for a waiver from the personal guarantee requirement, as permitted in §723.10(e).

The Board notes the Office of the Comptroller of the Currency and the Office of Thrift Supervision do not impose a legal requirement on national banks and savings associations to obtain principals' personal guarantees before extending credit to a business, but that personal guarantees are nonetheless an industry practice. The

Board also notes that the SBA requires personal guarantees under its microloan, 7(a), and 504 loan programs. The Board, therefore, encourages RegFlex credit unions to consider personal guarantees as a risk mitigation tool.

Thirty-seven commenters supported the provision on unsecured MBLs as proposed. Some of these commenters thought the proposal would enable credit unions to expand the potential number of MBL borrowers they could serve and allow them to be competitive with other financial institutions. One commenter stressed how valuable the increase in the unsecured lending authority is to credit unions that partner with the SBA because SBA guidelines allow lenders to make a SBA loan to a business with sufficient ability to repay the loan, even when there is not enough collateral to cover the whole request. Accordingly, the commenter stated, SBA lenders could often be faced with a loan amount in excess of the value of the collateral, so credit unions need sufficient unsecured lending limits to fund this uncollateralized gap.

Sixty-nine commenters stated that the provisions on unsecured MBLs are too restrictive. These commenters offered various suggestions to relax the limits placed on unsecured loans to one borrower and the aggregate amount of unsecured loans a credit union is permitted to make. Three commenters opposed allowing credit unions to make unsecured MBLs.

Section 723.7(c) of the final rule adopts the provisions on unsecured lending as proposed. While many credit unions have requested that the final rule provide greater

latitude, the Board finds it prudent to maintain the proposed limits in order to monitor the manner in which credit unions engage in unsecured business lending. The Board also believes that, until it has the opportunity to evaluate the progress of credit unions with unsecured MBLs, the waiver process is sufficient for those credit unions seeking to exceed the rule's current limitations. The waiver process affords NCUA Regional Directors the opportunity to review the safety and soundness considerations of each applicant's lending program on a case-by-case basis.

Ninety-four commenters supported the exemption from the LTV requirements for consumer-type vehicle MBLs. Many of the commenters stated the change is long overdue because the distinctions between a car loan for business purposes and a car loan for consumer purposes are slim. One commenter stated it supported the proposal because the exclusion includes leases of these vehicles and more than one vehicle to an individual, association, organization or business entity. Eleven commenters asked for clarifications on the vehicles covered under the exemption or an expansion of the exemption. Nine of these commenters asked that the Board extend the exemption to any titled vehicle.

Section §723.7(e) retains the standard proposed by the Board because it believes that the vehicles covered present little or only minimally greater risk than a comparable consumer loan. The Board opposes extending this exemption to all titled vehicles because there is not a readily available market for all types of titled vehicles as there is

for consumer-type cars, vans, pick-up trucks, and SUVs. In taking advantage of this rule exception for certain vehicle MBLs, credit unions should establish lending terms, including collateral requirements, for these loans that reflect best industry practices. The Board notes that sound lending practices require that LTV ratios and the term of the loan be consistent with the depreciation schedule of any vehicle used for a particular type of business.

As stated in the proposed rule's preamble, the Board intends this exclusion to be used to finance business use or combined personal/business use vehicles and not, for example, to finance fleet purchases. One commenter asked the Board to clarify the concept of a fleet of cars. A fleet is defined as "a group of vehicles, as taxicabs . . . , owned or operated as a unit." Webster's II New Riverside University Dictionary (1994) at 486. The final rule clarifies that a fleet of vehicles is not included in the vehicle exception to the LTV requirements because, when a business requires the use of a fleet of vehicles, it is likely these vehicles will depreciate far more quickly than vehicles used for personal use or a combined personal/business use.

Reserves for Classified Loans, Sections 723.14 and 723.15

The final rule deletes and reserves §§723.14 and 723.15, which addressed the classification of MBLs for losses and reserving requirements, because NCUA's Interpretive Ruling and Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Federally-Insured Credit Unions (FICUs) No. 02-

3 provides FICUs the appropriate guidance. 67 FR 37445, May 29, 2002. Six commenters specifically supported the deletion of these provisions.

Effect of Purchased Loans and Purchased Participation Interests, Section 723.16

In the CUMAA, Congress established an aggregate limit on MBLs made by individual FICUs. A credit union is exempt from the aggregate limit if it: (1) was chartered for the purpose of making MBLs; (2) has a history of primarily making MBLs; (3) serves predominantly low income members; or (4) is a community development financial institution. For credit unions that are not exempt, the amount of the aggregate limit is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's assets. Thus, for credit unions with a net worth ratio of 7% or more, the limit is 12.25% of assets. Also, certain loans, such as those below \$50,000 in amount and those covered by a government guarantee, are excluded from the MBL definition. 12 U.S.C. 1757A.

The statutory language establishing the aggregate limit provides that "no insured credit union may make any member business loan that would result in the total amount of such loans outstanding" in excess of the limit. 12 U.S.C. 1757a(a) (emphasis added). The Board believes that this language lends itself to several possible interpretations. The narrowest interpretation would apply the limit only to loans made by a credit union to its members and not to loans and loan interests purchased from another lender. A second interpretation would apply the limit to all business loans to a credit union's

members, whether made by the credit union or purchased from another lender, but not to purchases of loans or loan interests where the borrower is not a member. The most inclusive interpretation would apply the limit to all business loans, whether made or purchased, and irrespective of whether the borrower is a member.

All FCUs are authorized to purchase participation interests in loans made by other lenders to credit union members. 12 U.S.C. 1757(5)(E); 12 CFR 701.22. The borrower need not be a member of the purchasing credit union, only a member of a participating credit union. 12 CFR 701.22(d)(2). In addition, an FCU generally may purchase eligible obligations of its members from any source if the loans are those the FCU is empowered to grant. 12 U.S.C. 1757(13); 12 CFR 701.23(b). Also, although not specifically addressed in the proposed MBL rule, credit unions eligible for NCUA's regulatory flexibility program are authorized to purchase whole loans from other FICUs, including business purpose loans, irrespective of whether the borrower is a member of the purchasing credit union. 12 CFR 742.5.

In the proposed rule, the Board requested comment on the least constraining interpretation of the aggregate limit on MBLs, that is, only business loans made by a credit union to its members would have counted against the aggregate limit. The Board believes this proposal is consistent with the plain language of the Federal Credit Union Act establishing a limit on member business loans made by a FICU. The Board also believes the proposal is consistent with the congressional intent that credit unions not make business loans at the expense of the consumer loan needs of members and that

the credit union system not take on undue risk as a result of over-concentration of MBLs. See Senate Report 105-193 for a discussion of congressional intent.

In the proposal, the Board addressed the concern that purchasing MBLs might divert a credit union from its responsibility to extend consumer loans and minimize risk related to concentration of MBLs. The Board noted that a credit union's member-elected board of directors would meet its own members' loan demands first and purchase loans made by other lenders only as a means of placing excess funds to maximize returns to their member shareholders. The proposed rule addressed the safety and soundness concerns both by requiring that the purchasing credit union perform its own due diligence on all purchased loans and loan interests and by treating a purchase as a business loan asset for all other purposes, such as loan-to-one-borrower limits and risk-based net worth requirements.

As previously stated, credit unions and credit union related commenters were supportive of the proposal, but some questioned the basis for distinguishing between originations and purchases. Banks and their representatives argued that the proposal was inconsistent with a congressional intent to limit business lending by credit unions. The U.S. Treasury Department suggested that the proposed treatment of participation interests would create a "loophole" to escape the aggregate limit on individual credit unions established by Congress. On the other hand, two congressional sponsors of CUMAA urged NCUA to use its maximum flexibility to enable credit unions to meet their members' business loan needs.

As explained in the discussion of §723.1(d) and (e) above, the Board has addressed the commenters concerns by making certain changes to the proposed rule. First, the Board has determined that business purpose loans to members should be included in the aggregate limit whether the loan was made by the credit union or purchased from another lender. Thus, for example, if a credit union forms a CUSO to originate business loans to the credit union's members and then purchases those loans from the CUSO, the purchased loans will count against the credit union's limit. This change is addressed in §723.1(d) of the final rule.

On the other hand, purchases of nonmember loans and participation interests, as authorized under certain conditions in NCUA's rules and some state laws and rules, do not involve the provision of member loan services, and the acquired loan assets are not MBLs. The Board continues to believe that these purchases will be made only as a productive method of placing excess funds after member loan demands are met, and that they need not count against the purchasing credit union's aggregate MBL limit. The Board believes it is important to avoid unnecessary interference with the ability of credit unions to place their excess funds in the manner that best serves the credit union, its members, and the credit union system. A credit union that has, for example, 10% of its assets in MBLs and no further current business loan demand, should be able to place excess funds in participation interests of loans made by another credit union without being concerned that it will bar the purchasing credit union from meeting its own members' future loan needs. Purchasing participation interests, or whole loans in the

case of a RegFlex credit union, provides a better rate of return for the credit union and its members as compared to a typical investment asset, provides for risk diversification within the credit union system, and fosters the cooperative spirit that has traditionally existed and continues to exist among credit unions. Purchased nonmember participation interests, however, remain as loans on the credit union's balance sheet even though, under this regulatory standard, they are not MBLs for purposes of the aggregate MBL cap.

Recognizing that a purchased business loan or participation interest of a nonmember is a business loan asset with all of the attendant risks, the final rule does adopt the proposed rule's treatment of these assets as MBLs for purposes of the safety and soundness requirements of NCUA's regulations. A participating credit union, therefore, must otherwise comply with Part 723 and subject these loans to the PCA risk-weighting standards under Part 702 for MBLs as though the credit union had originated the loans. Thus, for example, the purchasing credit union will be required to do its own independent underwriting review and treat the loan the same as an MBL for purposes such as loan-to-one-borrower limits and construction and development loan limits. This change is accomplished, as previously discussed, by adding a new subsection (e) to §723.1, "What is a Member Business Loan?" This subsection provides that purchased nonmember loans and participation interests are treated the same as MBLs for all purposes under the rule except the aggregate limit.

With respect to the aggregate limit on MBLs for individual credit unions and to address concerns that the proposed rule would have created a loophole enabling credit unions to escape the limit, the final rule requires Regional Director approval of any transaction that would cause the total of purchased nonmember business loans and nonmember participation interests, when added to the credit union's MBLs, to result in an amount in excess of the credit union's aggregate limit on MBLs. If the credit union is a FISCO, the request must be submitted to the state supervisory authority for approval. If the state supervisory authority approves the request, the state supervisor will forward it to the regional director for approval. This is consistent with the treatment of waiver requests for FISCUs under the MBL rule. An application submitted pursuant to this requirement must include a copy of the credit union's business loan policies. The application must confirm that the credit union adheres to all aspects of NCUA's MBL rules with respect to purchases of nonmember business loans and participation interests, except the aggregate MBL limit. The application must include the credit union's proposed loan limit on nonmember loans and nonmember participation interests. Finally, the application must attest that the purchase is not being used, in conjunction with one or more other credit unions, in a manner that has the effect of trading MBLs that would otherwise exceed the aggregate limit. Upon receipt of a completed application, the Regional Director will issue a decision within thirty days. In the case of a FISCO, the regional director will issue a decision within 30 days of receipt of a completed application and the state supervisory authority's approval.

The application requirement responds to commenter concerns that some credit unions may use the authority to purchase nonmember loans as a device to swap loans and evade the aggregate limit. This process will enable NCUA and the state supervisors to ensure that the authority to purchase nonmember loans and participation interests is not used to trade loans and circumvent the aggregate limit. Further, it will ensure that purchasing credit unions have conducted their own independent review and otherwise complied with the safety and soundness requirements of the regulations. The Board notes that the final rule does not permit a credit union to seek approval to exceed the aggregate limit on MBLs for member loans or member participation interests made by the credit union or purchased from another lender. The application requirement regarding nonmember business loans and participation interests is set forth in §723.16(b) of the final rule.

Net Member Business Loan Balance (NMBLB), Section 723.21

The final rule adopts the phrase “net member business loan balance” as a new definition in §723.21 and uses it in various sections in the rule, including §§723.1, 723.3, 723.8, and 723.16. The NMBLB definition is:

[T]he outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is secured by shares in the credit union, or by shares or deposits in other financial institutions, or by a lien on the member’s primary residence, or insured or guaranteed by any agency of

the federal government, a state or any political subdivision of such state, or subject to an advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state, or sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

The NMBLB definition reflects NCUA's interpretation of various provisions in the MBL rule since the 1999 MBL rule was issued and incorporates several exclusions derived from CUMAA. This definition is key to determining: whether a loan qualifies as an MBL; which portion of an MBL is included in the calculation of the loans to one borrower limit; and which portion of an MBL is included in the calculation of a credit union's total aggregate MBL limit. The Board notes that, because the NMBLB definition excludes participation interests sold without recourse from the selling credit union's MBL limits, neither the originating credit union nor a participating credit union count participations against their MBL aggregate cap provided, as discussed above, the loan participation is not in a loan made to a member of the participating credit union and the participating credit union has obtained a waiver, if required under the circumstances. The Board also notes the final rule includes language clarifying that participations sold without recourse must qualify for true sales accounting under GAAP so that the rule accurately reflects the agency's interpretation over the last several years.

The proposed rule contained a substantially similar definition using a different term, "outstanding member business loan balance." Several commenters found the definition

confusing because the term's use of the word "outstanding" did not accurately reflect the calculations required as part of the definition. In effect, the proposed definition required a netting of the various exclusions in the definition. The Board has changed the term to "net member business loan balance" and simplified the definition to make it easier to understand.

Seventy-four commenters approved of the proposed definition. Most of these commenters stated it will enable credit unions to easily ascertain the factors involved in calculating the MBL threshold and various limit calculations, as well as providing more flexibility in making MBLs. Three stated the new term recognizes the balances that represent true risk to a credit union. Two bank commenters opposed the new term.

One commenter asked the Board to provide examples to assist credit unions in calculating multiple business purpose loans to one borrower. This commenter asked how much a credit union reports as an MBL when it has \$35,000 in business purpose loans to a member and makes a \$40,000 business purpose loan to the same member -- \$40,000, \$25,000 or \$75,000? The credit union would count the \$40,000 loan as an MBL and would comply with all of the requirements of Part 723 in making this loan because the loan caused the aggregate amount of business purpose loans to the member to exceed the \$50,000 threshold in §723.1(b)(3). The credit union, therefore, must comply, for example, with the rule's direct experience requirements and the LTV standards when making the loan, as well as count the MBL against the credit union's aggregate MBL limit in §723.16. When the member pays down the amount of the total

business purpose loans owed to the credit union so that the aggregate amount falls below the \$50,000 threshold, the credit union is no longer required to report the \$40,000 loan as an MBL.

For purposes of the loans-to-one borrower limitation under §723.8, the same calculation applies. The \$40,000 MBL applies towards the member's one borrower limit of the greater of 15% of the credit union's net worth or \$100,000, until the aggregate amount of business purpose loans held by the member is less than \$50,000. The member, however, is still subject to the Federal Credit Union Act's limitation on the total amount of loans made to one borrower of no more than 10% of the credit union's unimpaired capital and surplus. 12 U.S.C. 1757(5)(A)(x).

Another commenter asked for clarification on the manner in which a loan that has a partial guarantee from the SBA is analyzed with the NMBLB definition. As discussed in the 1999 final rule's preamble, a credit union only counts the amount of the loan that is not guaranteed by the SBA towards the \$50,000 threshold in §723.1(b)(3) to determine if a business purpose loan is an MBL. 64 FR 28721, 28722, May 27, 1999. Consistent with this interpretation, a credit union that makes a \$100,000 business purpose loan, of which 75% of the loan amount is guaranteed by a government agency, counts only \$25,000 towards the MBL threshold. 12 CFR 723.1(b)(3). Because this amount of \$25,000 is less than \$50,000, the loan is not an MBL and is not subject to Part 723.

This example demonstrates loan analysis for purposes of Part 723:

Loan 1 to Company in January 2003: \$40,000

Loan 2 to Company in February 2003: \$80,000 with a 75% government guarantee

- Loan 1 is not an MBL because it is under the \$50,000 threshold.
- Loan 2 has an NMBLB of \$20,000 (25% of \$80,000) but when added to Loan 1, the amount of business purpose loans to the member exceeds \$50,000, so Loan 2 is an MBL and must comply with all of the requirements of Part 723.
- FCU must obtain a lien on Company's collateral valued at \$100,000 in order to make Loan 2.
- FCU counts \$20,000 against its aggregate MBL limit and \$20,000 towards Company's limit on loans to one borrower.
- FCU must factor the entire loan amount of Loan 2, \$80,000, as an MBL into the standard RBNW calculation of the PCA rule until the loan is fully paid.

Loan 1 is paid down to \$15,000 in April 2003.

- Loan 2 is no longer an MBL for purposes of Part 723 because the total amount of business purpose loans to Company is \$35,000.

Loan 3 is a participation purchased in a loan made to Company on May 2003: \$25,000

- Loan 3 is an MBL because combined with the NMBLBs of Loans 1 and 2, Company's aggregate NMBLBs is \$60,000.

Loan 4 Unsecured Line of Credit to Company in June 2003: \$15,000

- Loan 4 is an MBL because Company's aggregate NMBLBs for all four loans totals \$75,000, which exceeds the \$50,000 threshold.

- As of June 2003, FCU counts Loan 3's NMBLB of \$25,000 and Loan 4's NMBLB of \$15,000 against its aggregate MBL cap and against Company's loans-to-one borrower limit.
- For PCA purposes, FCU calculates the standard RBNW based on the outstanding balances on Loans 2, 3, and 4 in accordance with §702.106(b).

One commenter asked that NCUA amend its Form 5300 call report instructions to reflect the changes in the final rule. NCUA will amend the call report after the agency gives the public notice and an opportunity to comment on any proposed changes in accordance with the Administrative Procedure Act and the Paperwork Reduction Act of 1995. The Board anticipates that this process will take several months.

The final rule deletes and reserves §723.9, which addressed calculation of the limit on loans to one borrower, because the NMBLB definition contains all of the rule's exclusions from this calculation, making §723.9 unnecessary.

Effect of Final Rule on Approved State Rules

State supervisory authorities may continue to seek exemptions for their FISCUs from NCUA's MBL rule as set forth in §723.20. The seven states that have already received an exemption from the Board will now have three options after the effective date of this rulemaking: 1) state supervisors may rescind their current MBL rules and require their charters to comply with NCUA's new rule; 2) they may maintain their rules as the Board

had approved them; or 3) they may seek approval from the Board to adopt any variances from those rules the Board previously approved, in accordance with the process outlined in §723.20. Commenters asked that the Board adopt a process for NCUA staff approval for any of the seven states that want to update their rules to the new NCUA rule. As noted in the 1999 final rule's preamble, the Board must approve a state's rule before a FISCO is exempt from NCUA's MBL rule. 64 FR 28721, 28728, May 27, 1999. The Board, therefore, is responsible for reviewing any state rule amendments to make a determination as to whether the state regulation, as a whole, minimizes the risk and accomplishes the overall objectives of NCUA's rule. The Board's intent is that any revisions to exempted state rules that simply update those rules to parallel changes in NCUA's rule will be approved on an expedited basis.

Section 702.106, Standard Risk-Based Net Worth Component for MBLs

The final rule expands the standard risk-based net worth (RBNW) component for MBLs to three tiers, from the current two. The bottom tier is risk-weighted at 6% and consists of the amount of MBLs less than or equal to 15% of total assets. The middle tier is risk-weighted at 8% and consists of the amount of MBLs greater than 15%, but less than or equal to 25%, of total assets. The top tier is risk-weighted at 14% and consists of the amount of MBLs in excess of 25% of total assets.

Twenty-six commenters stated the expansion of the standard PCA RBNW component dividing the portfolio of MBLs into three tiers is justified by the consistently low loss history of MBLs since 1998 as well as their unique characteristics. Commenters stated

the proposal is a reasonable way to protect the safety and soundness of a credit union and accurately reflects the true underlying risk of MBLs. Several of these commenters noted that this measure offers appropriate relief with regard to RBNW requirements. First, they noted that, those credit unions that were chartered primarily to extend business loans or that have history of primarily extending business loans will benefit from the 3-tiered risk weights by assisting such credit unions in managing the business loan portfolio and RBNW. Additionally, they stated purchased participations will be subject to PCA. Credit unions that plan to engage in significant participation activity will benefit from the new risk portfolios and may better manage participations and maintain adequate net worth. Fifty-two commenters stated the change is not useful as it could be because it overstates the risk. They offered alternatives to the proposed standards. The Board disagrees that the proposal overstates risks and incorporates the rationale articulated in the proposed rule's preamble regarding the appropriateness of the final rule's standard RBNW component into this rulemaking. 68 FR 16450, 16453, Apr. 4, 2003.

Five commenters stated that NCUA should allow for further risk reduction under PCA for MBLs that provide balloon or call provisions under which a loan matures within five years. They also asked that NCUA permit credit unions to include loans with five years or less in maturity in the lowest risk-weighted tier when calculating PCA. The suggestions of these commenters fail to take into account the credit risk of MBLs as well as their interest rate risk; regardless of a loan's maturity, credit risk still exists. The final rule, therefore, retains the provisions the Board proposed.

One commenter noted that the NMBLB definition may cause some confusion for credit unions when calculating the standard RBNW requirement under §702.106(b) because the PCA rule requires risk-weighting of “member business loans outstanding.” For purposes of Part 702, when a credit union classifies a loan as an MBL under Part 723 at the time it makes or purchases a loan or participation interest, that loan remains an MBL for calculating the RBNW requirement until the loan is paid off. This is another issue that the Board will clarify in its future amendments to the Form 5300 call report.

CUSO Business Loan Origination, Section 712.5

The final rule adds business loan origination to the CUSO regulation’s list of permissible activities in paragraph (c) of §712.5.

Seventy-five commenters supported the amendment to the CUSO rule. Many of these commenters stated that by authorizing CUSOs to originate business loans, credit unions will be able to benefit from economies of scale by pooling their investments in a business lending CUSO, thus permitting them to offer MBLs to members that may otherwise be unavailable through the credit union or other lenders. Eight bank commenters opposed the proposal and stated NCUA should reject it because it circumvents the statutory aggregate MBL limit placed on credit unions.

Four commenters asked that the final rule elaborate on the word “originate.” They stated it is arguably appropriate that a CUSO conduct functions such as taking business loans applications, conducting analysis, preparing documentation, arranging for title searches or similar services, loan servicing, and review and related services. They also stated that it may also be appropriate for a CUSO to fund loans. Accordingly, they asked that the Board define the term “originate” to establish what activity is permissible through a CUSO. The final rule allows CUSOs to make business purpose loans, just as CUSOs are permitted to engage in consumer mortgage loan origination, meaning to fund or make consumer mortgage loans under §712.5(d). This is separate from the already recognized authority of CUSOs to engage in loan support services that include loan processing and servicing under §712.5(j).

The U.S. Treasury Department stated in its comment that it did not object to allowing CUSO business loan origination in itself but expressed concern that the proposed rule excluded participation interests in CUSO-originated MBLs purchased by credit unions from counting towards the MBL cap. As detailed in the discussion regarding §723.16 above, the final rule does not permit a credit union to exclude any participation interest it has purchased in a loan made to one of the credit union’s members. This includes loan participations originated by a CUSO.

Four commenters noted that a revision to the loan participation rule, 12 CFR 701.22, was necessary to make it clear that FCUs may purchase MBL participations from their CUSOs. On June 26, 2003, the Board proposed an amendment to §701.22(a)(4) which

will clarify that CUSOs, as credit union organizations, are eligible organizations in which credit unions may enter into participation agreements. 68 FR 39866, Jul. 3, 2003.

FISCUs are subject to applicable state law on this issue.

Two commenters asked the Board to clarify that CUSOs are not subject to the MBL limitations in Part 723. These commenters are correct in that CUSOs are not required to comply with the various requirements and limitations in Part 723 when originating business loans. The Board reminds FCUs that, when entering into eligible obligation or participation agreements with CUSOs or other eligible organizations, FCUs must comply with all applicable regulations, including the MBL rule. See 12 CFR §§701.22, 701.23.

REGULATORY PROCEDURES

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (those under \$10 million in assets). The final member business loan relaxes some of the rule's existing standards or clarifies current requirements. In addition, less than 5% of small credit unions grant member business loans. The NCUA

Board, therefore, has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions.

Accordingly, a regulatory flexibility analysis is not required.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule liberalizes current requirements and standards applicable to all federally insured credit unions and will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - - Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act, 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 704

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 712

Credit, Credit unions.

12 CFR Part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 742

Credit unions.

By the National Credit Union Administration Board on September 24, 2003.

Becky Baker

Secretary of the Board

For the reasons stated in the preamble, NCUA revises 12 CFR chapter VII as set forth below:

PART 702 -- PROMPT CORRECTIVE ACTION

1. The authority citation for part 702 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1790d.

2. Amend §702.106 as follows:
 - a. Revise paragraph (b) to read as set forth below; and
 - b. Revise Table 4 following paragraph (h) to read as set forth below:

§702.106 Standard calculation of risk-based net worth requirement.

* * * * *

(a) * * *

(b) Member business loans outstanding. The sum of:

(1) Six percent (6%) of the amount of member business loans outstanding less than or equal to fifteen percent (15%) of total assets;

(2) Eight percent (8%) of the amount of member business loans outstanding greater than fifteen percent (15%), but less than or equal to twenty-five percent (25%), of total assets; and

(3) Fourteen percent (14%) of the amount in excess of twenty-five percent (25%) of total assets;

* * * * *

TABLE 4 -- §702.106 STANDARD CALCULATION OF RBNW REQUIREMENT

<i>Risk portfolio</i>	<i>Amount of risk portfolio (as percent of quarter-end total assets) to be multiplied by risk weighting</i>	<i>Risk weighting</i>
(a) Long-term real estate loans	0 to 25.00% over 25.00%	.06 .14
(b) MBLs outstanding	0 to 15.00% >15.00% to 25.00% over 25.00%	.06 .08 .14
(c) Investments	<u>By weighted-average life:</u> 0 to 1 year >1 year to 3 years >3 years to 10 years >10 years	.03 .06 .12 .20
(d) Low-risk assets	All %	.00
(e) Average-risk assets	All %	.06
(f) Loans sold with recourse	All %	.06
(g) Unused MBL commitments	All %	.06
(h) Allowance	Limited to equivalent of 1.50% of total loans (expressed as a percent of total assets)	(1.00)
A credit union's RBNW requirement is the sum of eight standard components. A standard component is calculated for each of the eight risk portfolios, equal to the sum of each amount of a risk portfolio times its risk weighting. A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement.		

3. Revise Appendix A to Subpart A of Part 702 to read as follows:

APPENDIX A – EXAMPLE STANDARD COMPONENTS FOR RBNW REQUIREMENT, §702.106
(EXAMPLE CALCULATION IN BOLD)

<i><u>Risk portfolio</u></i>	<i>Dollar balance</i>	<i>Amount as percent of quarter-end total assets</i>	<i>Risk weighting</i>	<i>Amount times risk weighting</i>	<i>Standard component</i>
Quarter-end total assets	200,000,000	100.0000 %			
(a) Long-term real estate loans Threshold amount: 0 to 25% Excess amount: over 25%	60,000,000	30.0000 % = 25.0000 % 5.0000 %	 .06 .14	 1.5000 % 0.7000 %	2.20 %
(b) MBLs outstanding Threshold amount: 0 to 15% Intermediate tier: >15% to 25% Excess amount: over 25%	35,000,000	17.5000 % = 15.0000 % 2.5000 % 0.0 %	 .06 .08 .14	 0.9000 % 0.2000 % 0.0 %	1.10 %
(c) Investments <i>Weighted-average life:</i> 0 to 1 year >1 year to 3 years >3 years to 10 years >10 years	50,000,000 = 24,000,000 15,000,000 10,000,000 1,000,000	25.0000 % = 12.0000 % 7.5000 % 5.0000 % 0.5000 %	 .03 .06 .12 .20	 0.3600 % 0.4500 % 0.6000 % 0.1000 %	1.51 %
(d) Low-risk assets	4,000,000	2.0000 %	.00		0 %
Sum of risk portfolios (a) through (d) above	149,000,000	74.5.000%			
(e) Average-risk assets	51,000,000	25.5000 %^{a/}	.06		1.53 %
(f) Loans sold with recourse	40,000,000	20.0000 %	.06		1.20 %
(g) Unused MBL commitments	5,000,000	2.5000 %	.06		0.15 %
(h) Allowance	2,040,000.00 ^{b/}	1.0200 %	(1.00)		(1.02) %
Sum of standard components: RBNW requirement ^{g/}					6.67 %

^{a/} The Average-risk assets risk portfolio percent of quarter-end total assets equals 100 percent minus the sum of the percentages in the four risk portfolios above (i.e., Long-term real estate loans, MBLs outstanding, Investments, and Low-risk assets).

^{b/} The Allowance risk portfolio is limited to the equivalent of 1.50 percent of total loans. For an example computation of the permitted dollar balance of Allowance, see worksheet in Appendix B below.

^{c/} A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement. The dollar equivalent of RBNW requirement may be computed for informational purposes as the RBNW requirement percent of total assets.

4. Revise Appendix D to Subpart A of Part 702 to read as follows:

APPENDIX D – EXAMPLE OF MEMBER BUSINESS LOANS
ALTERNATIVE COMPONENT, §702.107(b)
(EXAMPLE CALCULATION IN BOLD)

<i>Remaining maturity</i>	<i>Dollar balance of MBLs by remaining maturity</i>	<i>Percent of total assets by remaining maturity</i>	<i>Alternative risk weighting</i>	<i>Alternative component</i>
<i>Fixed-rate MBLs</i>				
0 to 3 years	6,000,000	3.0000 %	.06	0.1800 %
> 3 years to 5 years	4,000,000	2.0000 %	.09	0.1800 %
> 5 years to 7 years	2,000,000	1.0000 %	.12	0.1200 %
> 7 years to 12 years	0	0.0000 %	.14	0.0000 %
> 12 years	0	0.0000 %	.16	0.0000 %
<i>Variable-rate MBLs</i>				
0 to 3 years	17,000,000	8.5000 %	.06	0.5100 %
> 3 years to 5 years	4,000,000	2.0000 %	.08	0.1600 %
> 5 years to 7 years	2,000,000	1.0000 %	.10	0.1000 %
> 7 years to 12 years	0	0.0000 %	.12	0.0000 %
>12 years	0	0.0000 %	.14	0.0000 %
Sum of above equals Alternative component*				1.25 %

* Substitute for standard component if lower.

5. Revise Appendix H to Subpart A of Part 702 to read as follows:

APPENDIX H -- EXAMPLE RBNW REQUIREMENT USING ALTERNATIVE COMPONENTS
(EXAMPLE CALCULATION IN BOLD)

<i>Risk portfolio</i>	<i>Standard component</i>	<i>Alternative component</i>	<i>Lower of standard or alternative component</i>
(a) Long-term real estate loans	2.20 %	2.85 %	2.20 %
(b) MBLs outstanding	1.10 %	1.25 %	1.10 %
(c) Investments	1.51 %	1.37 %	1.37 %
(f) Loans sold with recourse	1.20%	1.03%	1.03%
			Standard component
(d) Low-risk assets			0 %
(e) Average-risk assets			1.53 %
(g) Unused MBL commitments			0.15 %
(h) Allowance			(1.02) %
RBNW requirement* Compare to Net Worth Ratio			6.53 %

* A credit union is "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement

PART 704—CORPORATE CREDIT UNIONS

6. The authority citation for part 704 is revised to read as follows:

Authority: 12 U.S.C. 1766(a), 1781, 1789.

7. Amend §704.7 paragraph (e)(2) by revising the sentence as follows:

§704.7 Lending.

* * * * *

(e) * * *

(2) Corporate CUSOs are not subject to part 723 of this chapter.

* * * * *

8. Amend §704.11 by removing paragraph (b)(4).

9. Amend §704.11(c) by revising the letter (l) to the letter (j).

PART 712—CREDIT UNION SERVICE ORGANIZATIONS (CUSOs)

10. The authority citation for part 712 continues to read as follows:

Authority: 12 U.S.C. 1756, 1757(5)(D) and (7)(I), 1766, 1782, 1784, 1785, and 1786.

11. In §712.5, redesignate paragraphs (c) to (q) as paragraphs (d) to (r) and add new paragraph (c) to read as follows:

* * * * *

(c) Business loan origination;

* * * * *

PART 723—MEMBER BUSINESS LOANS

12. The authority citation for part 723 continues to read as follows:

Authority: 12 U.S.C. 1756, 1757, 1757A, 1766, 1785, 1789.

13. Amend §723.1 as follows:

a. Add the phrase “the net member business loan balances are” after the word “when” in paragraph (b)(3);

b. Add paragraphs (c), (d), and (e).

§723.1 What is a member business loan?

* * * * *

(c) Loans to credit unions and credit union service organizations. This part does not apply to loans made by federal credit unions to credit unions and credit union service organizations. This part does not apply to loans made by a federally insured, state-chartered credit union to credit unions and credit union service organizations if the credit union’s supervisory authority determines that state law grants authority to lend to these entities other than the general authority to grant loans to members.

(d) Purchase of member loans and member loan participations. Any interest a credit union obtains in a loan that was made by another lender to the credit union’s

member is a member business loan, for purposes of this rule and the risk weighting standards of part 702 of this chapter to the same extent as if made directly by the credit union to its member.

(e) Purchases of nonmember loans and nonmember loan participations. Any interest a credit union obtains in a nonmember loan, pursuant to §701.22 or part 742 of this chapter or other authority, is treated the same as a member business loan for purposes of this rule and the risk weighting standards under part 702 of this chapter, except that the effect of such interest on a credit union's aggregate member business loan limit will be as set forth in §723.16(b) of this part.

14. Amend §723.3 by revising paragraph (a) and paragraph (b) to read as

follows:

§723.3 What are the requirements for construction and development lending?

* * * * *

(a) The aggregate of the net member business loan balances for all construction and development loans must not exceed 15% of net worth. In determining the

aggregate balances for purposes of this limitation, a credit union may exclude any loan made to finance the construction of a single-family residence if a prospective homeowner has contracted to purchase the property and may also exclude a loan to finance the construction of one single-family residence per member-borrower or group of associated member-borrowers, irrespective of the existence of a contractual commitment from a prospective homeowner to purchase the property.

(b) The borrower must have a minimum of 25% equity interest in the project being financed, the value of which is determined by the market value of the project at the time the loan is made, except that this requirement will not apply in the case of a loan made to finance the construction of a single-family residence if a prospective homeowner has contracted to purchase the property and in the case of one loan to a member-borrower or group of associated member-borrowers to finance the construction of a single-family residence, irrespective of the existence of a contractual commitment from a prospective homeowner to purchase the property. Instead, the collateral requirements of §723.7 will apply; and

* * * * *

15. Revise §723.5 as follows:

§ 723.5 How do you implement a member business loan program?

(a) Generally. The board of directors must adopt specific business loan policies and review them at least annually. The board must also use the services of an individual

with at least two years direct experience with the type of lending the credit union will be engaging in. The experience must provide the credit union sufficient expertise given the complexity and risk exposure of the loans in which the credit union intends to engage. Credit unions do not have to hire staff to meet the requirements of this section but must ensure that the expertise is available. A credit union can meet the experience requirement through various approaches. For example, a credit union can use the services of a credit union service organization (CUSO), an employee of another credit union, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

(b) Conflicts of Interest. Any third party used by a credit union to meet the requirements of paragraph (a) of this section must be independent from the transaction and is prohibited from having a participation in the loan or an interest in the collateral securing the loan that the third party is responsible for reviewing, with the following exceptions:

(1) The third party may provide a service to the credit union related to the transaction, such as loan servicing;

(2) The third party may provide the requisite experience to the credit union and purchase a loan or a participation interest in a loan originated by the credit union that the third party reviewed; or

(3) A credit union may use the services of a CUSO that otherwise meets the requirements of paragraph (a) of this section even though the CUSO is not independent

from the transaction, provided the credit union has a controlling financial interest in the CUSO as determined under Generally Accepted Accounting Principles.

16. Amend §723.6 as follows:

a. Add the phrase “secured and unsecured” before the word “business” in paragraph (c);

b. Add “§723.7(c)(2) and” after the words “subject to” in paragraph (e);

c. Add the phrase “consistent with appropriate underwriting and due diligence standards, which also addresses the need for periodic financial statements, credit reports, and other data when necessary to analyze future loans and lines of credit, such as, borrower's history and experience, balance sheet, cash flow analysis, income statements, tax data, environmental impact assessment, and comparison with industry averages, depending upon the loan purpose” after the word “loan” in paragraph (g);

- d. Remove paragraphs (h) and (i) and redesignate paragraphs (j) to (m) as (h) to (k).

17. Revise §723.7 to read as follows:

§723.7 What are the collateral and security requirements?

(a) Unless your Regional Director grants a waiver, all member business loans, except those made under paragraphs (c), (d), and (e), must be secured by collateral as follows:

(1) The maximum loan-to-value ratio for all liens must not exceed 80% unless the value in excess of 80% is covered through private mortgage insurance or equivalent type of insurance, or insured, guaranteed, or subject to advance commitment to purchase by an agency of the federal government, an agency of a state or any of its political subdivisions, but in no case may the ratio exceed 95%;

(2) A borrower may not substitute any insurance, guarantee, or advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state for the collateral requirements of this paragraph.

(b) Principals, other than a not for profit organization as defined by the Internal Revenue Service Code (26 U.S.C. 501) or those where the Regional Director grants a

waiver, must provide their personal liability and guarantee. Federal credit unions and federally insured state-chartered credit unions that meet RegFlex standards, as determined pursuant to Part 742 of this Chapter, are exempt from this requirement and may make their own determination whether to require the personal liability and guarantee of principals.

(c) You may make unsecured member business loans under the following conditions:

- (1) You are well capitalized as defined by §702.102(a)(1) of this chapter;
- (2) The aggregate of the unsecured outstanding member business loans to any one member or group of associated members does not exceed the lesser of \$100,000 or 2.5% of your net worth; and
- (3) The aggregate of all unsecured outstanding member business loans does not exceed 10% of your net worth.

(d) You are exempt from the provisions of paragraphs (a), (b), and (c) of this section with respect to credit card line of credit programs offered to nonnatural person members that are limited to routine purposes normally made available under those programs.

(e) You may make vehicle loans under this part without complying with the loan-to-value ratios in this section, provided that the vehicle is a car, van, pick-up truck, or sports utility vehicle and not part of a fleet of vehicles.

18. Revise §723.8 to read as follows:

§ 723.8 How much may one member or a group of associated members borrow?

Unless your Regional Director grants a waiver for a higher amount, the aggregate amount of net member business loan balances to any one member or group of associated members must not exceed the greater of:

(a) 15% of the credit union's net worth; or

(b) \$100,000.

19. Remove and reserve §723.9.

20. Revise §723.10 to read as follows:

§723.10 What waivers are available?

You may seek a waiver for a category of loans in any of the following areas:

- (a) Appraisal requirements under §722.3;
- (b) Aggregate construction and development loans limits under §723.3(a);
- (c) Minimum borrower equity requirements for construction and development loans under §723.3(b);
- (d) Loan-to-value ratio requirements for business loans under §723.7(a);
- (e) Requirement for personal liability and guarantee under § 723.7(b);
- (f) Maximum unsecured business loans to one member or group of associated members under §723.7(c)(2);
- (g) Maximum aggregate unsecured member business loan limit under §723.7(c)(3); and
- (h) Maximum aggregate outstanding member business loan balance to any one member or group of associated members under §723.8.

21. Remove and reserve §723.14.

22. Remove and reserve §723.15.

23. Revise §723.16 to read as follows:

§723.16 What is the aggregate member business loan limit for a credit union?

(a) General. The aggregate limit on a credit union's net member business loan balances is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities. Loans that are exempt from the definition of member business loans are not counted for the purpose of the aggregate loan limit.

(b) Effect of nonmember loans and nonmember participations. If a credit union holds any nonmember loans or nonmember loan participation interests that would constitute a member business loan if made to a member, those loans will affect the credit union's aggregate limit on net member business loan balances as follows:

(1) The total of the credit union's net member business loan balances and the nonmember loan balances must not exceed the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets, unless the credit union has first received approval from the NCUA regional director.

(2) To request approval from the NCUA regional director, a credit union must submit an application that:

- (i) Includes a current copy of the credit union's member business loan policies;
- (ii) Confirms that the credit union is in compliance with all other aspects of this rule;
- (iii) States the credit union's proposed limit on the total amount of nonmember loans and participation interests that the credit union may acquire if the application is granted;

and

- (iv) Attests that the acquisition of nonmember loans and participations is not being used, in conjunction with one or more other credit unions, to have the effect of trading member business loans that would otherwise exceed the aggregate limit.

(3) A federal credit union must submit its request for approval to the regional director (a corporate federal credit union submits its request to the Director of the Office of Corporate Credit Unions). A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the application and its decision to the regional director (or if appropriate, the Director of the Office of Corporate Credit Unions). An approved application is not effective until it is approved by the regional director (or in

the case of a corporate federal credit union the Director of the Office of Corporate Credit Unions). The regional director will issue a decision within 30 days of receipt of a federal credit union's completed application or within 30 days of receipt of a completed application and the state supervisory authority's approval for a state chartered federally insured credit union.

24. Add the following definition to §723.21:

§723.21 Definitions.

* * * * *

Net Member Business Loan Balance means the outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is secured by shares in the credit union, or by shares or deposits in other financial institutions, or by a lien in the member's primary residence, or insured or guaranteed by any agency of the federal government, a state or any political subdivision of such state, or subject to an advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state, or sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

PART 742 – REGULATORY FLEXIBILITY PROGRAM

25. The authority citation for part 742 continues to read as follows:

Authority: 12 U.S.C. 1756 and 1766.

26. Amend §742.4(a) by removing the words “§703.12(c); and §703.16(b) of this chapter” and replacing them with “§703.12(c), §703.16(b), and §723.7(b) of this chapter.”